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The unfolding of the Asean economic crisis

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Abstract (Abstract): McFarlane examines the causes of the crisis in the East Asian economic community, analyzing current conditions and trends and considering what corrections must be made to remedy the situation. Predictions by both the World Bank and the IMF were way out of line, and contributed significantly to the meltdown experienced by Asian markets.

Full text: Let us begin by recalling that in 1995 the World Bank made in a firm prediction that average "East Asian" growth would be 7.5% annually. Here we see the unwarranted optimism about an economic "miracle" that contained no serious internal contradictions, no serious physical and environmental barriers, no weak underlying financial structures, but just keeps rolling on.

The super optimism of the World Bank forecast would be ludicrous if they had not been taken so seriously by senior academics and financial pundits, and if the targets and projections had not been used as the cornerstone of the economic changes forced on a number of Asian countries by the World Bank and IMF.

A similar approach to that held for so long within the top echelons of the World Bank-IMF complex may be found in official and semi-official publication of Australia's Department of Foreign Affairs: the White Paper, In the National Interest (1997) and the earlier Australia: The Southeast Asian Business Challenges (1994). In the first we read "Despite uncertainties, continuing high rates of saving, strong emphasis on education and strong prospects for foreign investment suggest that it is more likely than not that the economic growth of most of the industrialising countries in East Asia will remain at high levels over the next fifteen years" (p. 25), and further that "the ASEAN states constitute a high growth market of 500m. people with a combined Gross Domestic Product (GDP) comparable to that of China." Well both statements now look silly, but at least the White Paper did take into its assessment of some difficulties, if only to dismiss them, previous exercises on ASEAN affairs coming out of the East Asia Bureau of Foreign Affairs simply failed to enter into the growth equation of ASEAN such issues as institutional weaknesses, environmental degradation and shortages of physical infrastructure.

Defenders of the previous forecasting try to point out that there is a difference between a slowdown in growth rates which still leave some growth crumbs on the table and what can be described as negative growth -- zero or below. However, the very large size of the downsizing required of the previous targets and projections of growth is so severe that it has led not only to new paper plans, but to actual institutional change (particularly in Thailand, the Philippines, Korea and even in Japan). An example is the revamping of the whole way that the financial sector is to run its capital markets, which suggests that a serious economic crisis was really the issue.

Moreover, it has been increasingly recognised since the Thai crisis that a drop in the growth rate of GDP from (say) 8% to 5% can lead to a five-year period of large and stubborn unemployment and stagnation of output; this is largely because of the rising interest rates that are imposed by the financial "shake-out" of the finance sector of the kind being undertaken in Korea, Thailand, Philippines and Indonesia.

As a result of this recognition, a series of reductions in the growth rate outlook for East and Southeast Asian states have had to be made by various think-tanks, by brokerage firms and finance companies and by the IMF itself. These new and successively revived estimates, which came out as the financial meltdown proceeded have been summarised in Table 1.

Unfolding of the ASEAN Economic Crisis

The first round of the crisis occurred in the period 2 July 1997 to about June, 1998 and took the form of a speculative attack on the external value of the currencies of ASEAN states and of South Korea and Hong Kong. Thereafter the second round occurred which was a generalised crisis of the financial, banking and political system accentuated by the sharp fall of the Japanese economy into recession.

Table 1: Various Asian Growth Projections, Annual GDP Growth in %: Actual and Projected

Country	Japanese Institute for Development Studies		*16 Dec. 97	IMF 1998a	Bankers Trust
	Actual 1996	Projected 1997	Projected 1998	Projected 1998	Projected 1998
ASEAN					
Thailand	6.4	-0.3	5.4	-11.0	-6.4
Indonesia	8.0	5.7	4.1	-5.0	-13.4
Malaysia	8.6	8.1	6.6	2.5	-1.7
Philippines	5.7	5.1	4.8	2.5	
Vietnam	9.3	8.6	8.5	5.0	
N. Av.	7.3	4.3	5.2	2.5	
NIE's					
Korea	7.1	6.1	8.0	-1.0	-3.8
Taiwan	5.7	6.5	6.6	na	
Singapore	7.0	7.2	7.9	na	
Hong Kong	4.7	5.5	3.8	3.0	-1.3
N. Av.	6.3	6.2	4.5	3.0	
TINA	9.6	8.8	9.0	7.0	
Asia Av.	7.7	6.6	7.7		

Note: All figures from Japanese Institute for Development Studies are projected for more than 5% except for Indonesia, Philippines and Hong Kong. This Proved Super-optimistic. a. Report in the Philippine Daily Inquirer, 3-16 March 1995.

Enlarge this image.

In the first round there was usually present a failing construction boom financed by banks and finance trusts that were suffering, as a result of unwise lending, a dangerously high percentage of bad debt or non-performing loans in their overall loan portfolio. Also present were such phenomena as stagnating exports, a high level of foreign debt incurred by both the private and the public sectors and an overvalued exchange rate. This was the seedbed for speculative attacks and it soon became apparent that the dynamic interaction of four major economic variables could send any Asian economy with the "seedbed" mentioned into a downward spin. The four variables which will be referred to throughout this article are exchange rate fluctuation, a slump in share market values, rising rates and difficulties in the management of foreign debt as it matures for repayment.

As this stage the discussion in this article proceeds to the unfolding of the "fisrt round" of the crisis in individual countries of the ASEAN bloc.

Thailand: On the 2nd of July, 1997 there was a run on the Thai baht accompanied by a substantial capital flight. It was soon discovered that there was a very high level of foreign debt, that there were thousands of unsold condominium units and that the local banks and finance trusts were over committed to failing sectors and had abnormally high levels of "non-performing" loans. The IMF was called in and promised funds as a bailout to enable the large foreign debt to be paid as it matured. By the 27th of October, 1997 the baht had fallen in its external value from 26 baht to the US dollar to 40 baht to the dollar. This happened despite the emergency IMF loans that had already been offered and widely touted as the "solution" to the crisis.

Political instability did not help. Politicians were revealed to have exercised influenced in allowing the unsound loans to be made at all. Subsequently, the Thai government was toppled down. Austerity measures and a forced amalgamation of finance trusts and banks followed. The conditions in the IMF packages were very tough since as a low-wage country, there was little scope for real wage reductions to encourage employers to offer employment, and Thai economists estimated i that the attempt by the Chuan Leekpai government to reduce the government budget outlays (as demanded by the IMF) from 993 billion to 305 billion baht would be

accompanied by a drop of at least 1% in the GDP growth rate with large job losses.
The biggest albatross following the 17th October, 1997 drop in value to 40 baht per dollar was the growing problem of managing debt maturation. As of November, the foreign debt level stood at $US89 billion despite the fact that already in August the government had been forced to beg for an immediate rescue program of $US 1 7.2b.2 Then the problem of stock exchange values soon emerged. The value of Thai shares plunged in the last days of November 1997 to the lowest levels for a decade. In response, the assets of a number of suspended finance companies were sold at a big discount so that the value of the Thai stock exchange was stabilised, albeit at a low level. The circle was now closed: the successive Thai governments had brought on a "bubble" economy in the 1990s but under the impact of the crisis they eventually pricked the bubble.
Yet worries about repayment of foreign debt continued to affect stock exchange values, as well as interest rates. This worry was well-based as it was later revealed that the Thai Central Bank had run down almost all the country's foreign exchange reserves by the end of August,1997 which left Thailand vulnerable to further speculative attacks on its currency. Moreover, new estimates put the foreign debt level at $US89.8b. of which $US39.2 had been incurred by the private sector.
Risk and uncertainty were behind capial flight and other startling indicators kept coming in. One of these had to do with overseas trade, with the international current account deficit revealed as a record 1.73 trillion baht. With the admission of the seriousness of these figures, the planners began a process of scaling-down of their growth projections for the national economy, with the growth rate of GDP set in December for the year ahead now put at only 2.5%3 and a figure of 3.5% for 1998: both proved to be too optimistic and by March 1998 the IMF was talking about minus 5.0% which represented a tragic retreat, underlining the early unwillingness of both the Thai government and the IMF to face reality concerning Thailand's economic prospects.
As social stress and unemployment spread, the World Bank was brought in to offer a "social package" of $300 million. The Bank admitted that its sister organisation the IMF had underestimated the economic dislocation and social difficulties that would follow from the imposed Economic Reform.4 The Bank's action represented the first dim realisation in the top echelons of international finance that the "meltdown" in the Asian context was not just about monetary fluctuation, falling share prices and rising interest rates, but was about bankruptcies, long-term unemployment of labour and general social dislocation of Thai society. This was truly the case even if it was less spectacular than what went on show in Indonesia after New Year, 1998.
The second round of the Thai crisis came in June-July 1998, when a decision had to be made about the future of the bankrupt financial institutions and a clear move had to be made to break out of the vicious cycle of rising bad debts as firms were discouraged from settling their debts while the future of the banks remained problematical. At a closed meeting with 20 academics on the 19th of July the Finance Minister told them that the main choices the government had in deciding what to do about the bankrupt financial trusts were to sell them off individually; to merge them for sale; or to separate the assets and put the good ones into a healthy bank or possibly into a "bridge" bank on the Japanese model which "parks" non-performing loans. Whatever the final outcome it was clear that the Thai government was coming under pressure to shoulder the bad debts of the failed financial trusts and banks itself.
Indonesia: Among the Southeast Asian countries, Indonesia suffered the biggest fall in the foreign value of its currency, despite truly massive IMF assistance - and this long before the fall of Suharto and his quick replacement as president.
In June 1997 the exchange rate had been 2,500 rupiah per one US dollar, but at one point it touched 19,000 per US dollar before stabilising at 11,000 in March 1998 about six weeks before the Indonesia riots. The most immediate effects in the second half of 1997 was the cancellation of very large construction projects, many of them around the capital city, with immediate loss of thousand of jobs. Overall the numbers affected rose to over two million extra unemployed in the eight months after July 1997. These results were very dismal. Their roots lie in the collapse of new capital inflow. The high level of domestic and oversea debt and the perceived economic

cronyism leading to inefficient capital markets were the main turn-off for foreign investors.5 The Indonesian government, after some delay, estimated its foreign debt at US$117 billion as at the end of September 1997, of which $US53 billion was private sector debt. Not only was this an enormous figure for an economy of this size, but the debt-service ratio (or, the percentage of export earnings in a year taken up by debt repayment to foreigners) was very high at 35.5% and Indonesian economic officials were soon complaining that for every 100 rupiah that the currency depreciated against one American dollar, the level of foreign debt rose by $145m.6 At the point where depreciation of the external value of the rupiah reached 30% the Indonesians called in the IMF and got a large aid package to be used to pay debts as they fell due. This was a severe tests for Indonesian management of maturing debt, a test they failed to pass.

In accordance with IMF advice, growth rate projections were hurriedly cut back and this happened several times until a drop in the actual level of GDP was announced in mid-January, 1998. The trend towards more honesty in official reporting continued with the announcement that foreign debt was actually equivalent to 60% of GDP. Of this amount some $20 billion was needed for the settling of short-term debt and due for immediate repayment. Since this debt could not be met in the short run, the IMF were called in again, and the World Bank also agreed to supply $40 billion on the condition that a wide selection of big investment project was scrapped, and that no more funds would be channeled to crony companies or suspected non-performing assets.

A major weakness in these packages was spotted by international business and the research departments of the merchant banks involved in financial flows to Indonesia: the IMF and the World bank had no strategy for selling-off the assets of "suspect" companies after their financial restructuring had been enforced.

In the meantime, serious events were occurring in the real economy as a consequence of the instability in the monetary economy: during the months from October, 1997 to March 1998, manufacturing ouput collapsed in key sectors and as a result unemployment grew by another million. This grave situation had been reinforced by the rise in interest rates, and the drop in effective demand as real wages tumbled. Particularly hard hit were sales of electronics, motor cars and automotive spare parts, while the construction industry around Jakarta was noticeably in a state of collapse. At the end of February,1998 the level and nature of the foreign debt was again a major concern as it was revealed that the country was facing a private foreign debt of $72 billion and state foreign debt of $54 billion, indicating that no progress at all had been made in lifting the pall caused by high foreign debt levels. When Habibie came in as president, the rupiah did not stabilised, dipping 7% in the week beginning IS July, 1998. Moreover, the Economic Reform that Suharto had signed with the international banks and the IMF went into limbo while the Suharto family wealth was under official investigation.

In the meantime political turmoil continues and the issue of the social effects of the IMF-enforced reforms and austerity budgets, in particular the removal of subsidies for basic foodstuffs and mass transport did little to reduce the political heat, but quite the opposite.

Malaysia: During July-December,1997 the external value of the Malaysian ringit fell 39% and inevitably capital flight ensued. Immediately 20 billion ringgits (RM) were taken off the value of the stock market shares so that the government had to organise share-buying, costing RM70 billion, to prop up share prices.

The Malaysia government took a different stance toward the causes of the financial crisis and the role of the speculators and international fund managers as compared to other ASEAN leaders in Thailand, the Philippines, Singapore and Indonesia. They nominated particular foreign businessmen and speculators as the source of the trouble. They at first adamantly refused pressure from the IMF and foreign countries to allow foreigners to hold majority shareholdings in domestic firms. By early December, 1997 they were ready to announce their own Malaysian package which consisted of severe cuts in government expenditure, and a freeze on new bank lending. It was also foreshadowed that there would be restrictions on foreign travel by citizens. All of this was to be in the framework of much reduced growth projections. There was to be a Malaysian government bailout of the large firms that had run into difficulties in the wake of the currency meltdown, including the blue-chip market leader "Renong" which received RM700 million before collapsing with an estimated share value of RM20 billion

put under threat.
As in Indonesia, there was a rapid rise in unemployment and an ugly turn of events when it was officially announced that Malaysia would deport one million foreign workers, a majority of whom were Indonesians.
Singapore: Singapore is both a member of ASEAN and at the time one of the group of Asian countries classified as a "Newly Industrialised Country," or, more colloquially, a "tiger" economy. It has the strongest currency of the Southeast Asian states, which nevertheless suffered a 13% devaluation in the weeks following the Thai collapse. This forced the government to adopt some re-regulation of the financial system but the fact that the international fund managers were anxious to park a great deal of the capital fleeing from the rest of Asia in Singapore, and that the country had zero foreign debt helped Singapore to whether the financial storm. It is well known that domestically the government exercised tight control over finance capital, particularly through its notorious superannuation arrangements which compulsorily raised the national savings rate to very high levels and provided a cushion against the sort of capital flight that occured in such places as Thailand and the Philippines.
It must also be conceded, even in those circles promoting human rights, that Singapore has benefited from the very important factor calming the nerves of the foreign exchange dealers -- political stability. This factor is increasingly being seen in the decision-making processes of international business as a crucial criterion in deciding where to move international capital funds. In retropect, we can see that the Singapore stock exchange was actually able to reap advantages from the turmoil that led to capital flight from its ASEAN partners, for the Singapore capital and financial markets came to be seen as safe havens and some large European brokerage firms said that they would place customers funds there. In addition, large amount of money were moved by Chinese-Indonesian and Chinese-Malaysian taipans to Singapore for safekeeping and investment in and outside the region.
Vietnam: A recent member of ASEAN and ostensibly a socialist country, Vietnam was, nevertheless, drawn into the Asian financial turbulence and forced to devalue the dong by about 17% between July 1997 to July, 1998. The Vietnamese leaders expressed concern that foreign investors in direct manufacturing, as well as portfolio investment might leave Vietnam and the ASEAN region as a whole, damaging Vietnam's own "mini-tiger" ambitions in the process.
Actually the solid growth rates of 8% plus turned in by Vietnam in the 1990s had begun to slip to an estimated 5% in 1997-8. This result, however, is not simply a result of the ASEAN meltdown. The existence, since 1990 of freely floating exchange rates had already opened the economy to impulses from abroad such as higher import prices. However, Vietnam with its low real labour costs per unit will still be in a position to compete with Asian exports made cheaper by the round of devalution's. Remaining problems are due to system problems. Foreign investment is not use as effectively as it could be, due to bureaucratic delays in getting official approvals and licenses, as officials hold out for bribes. Inadequate physical infrastructure such as roads, ports, train lines and electric power are all drags on the movement and consignment of goods.
Moreover, the Vietnamese have retained a certain degree of economic planning-- to the annoyance of their tutors among the IMF technocrats. The remaining planning organs have been able to stop a full erosion of expenditure on welfare, so that "social packages" of the sort the World Bank contemplated for Thailand and Indonesia should not be required. As well, the state and some new institutions have consciously attempted to create new jobs, with some encouraging results have emerged in the labour-intensive sectors.
Finally, to return to political stability. This has been achieved at the moment in that there seems to be a period of consensus in Vietnamese day-to-day politics, with the Communists Party's monopoly of power somewhat in retreat. Political stability and moderately high GDP growth are good achievments in the current ASEAN climate, and may mean that Vietnam, one of the poorest members of ASEAN, will turn out to be one least affected by the events surrounding the currency turmoil in Southeast Asia.
Philippines: Despite a lot of brave talk by the administration, the Philippine economy was pulverised by the

currency crisis and projections for grwoth rates of 6.7% and then 5.8% p.a. were successively cut to 2.5%. The whole experience of the ASEAN economic crisis has been disastrous for the Philippines, with currency turmoil and stock exchange crashes in the monetary economy and declining business activity in many industrial sectors causing spiralling job losses. At first the Ramos administration tried to cover this up, and were abetted by some commentators who should have known better. However, in his "State of the Nation" address on 27th July 1998, the new President Joseph Estrada came clean, admitting that the economy was in severe crisis and that the government was financially bankcrupt.7

Given the disinformation campaign waged by the Ramos regime, it is worthwhile recapitulating what happend in the Philippines in reality in some detail. The movement of the currency's external rate went from 25 pesos per US$ to 35:1 in October,1997, 40 in December 1997, and 42 in July 1998. This movement was, simply, a massive devaluation which fed quickly into rising import prices. Since not only capital goods, construction materials, and raw material were imported, but a lot of food as well, the impact of cost of living was dramatic. Perhaps the most important monetary effects were felt in the series of stock market plunges and especially the repeated flights of capital, only part of which had returned to Manila by July 1998. With direct foreign investment dropping, as well as the more footloose portfolio capital making its exit, coming on top of a 30% devaluation, a desperate remedy was sought (as in Malaysia) in a credit squeeze using a high interest rate policy. The high interest rate policies in the Philippines were shown in the levels of bench-mark rates. Thus 91-day Treasury Bills were averaging 13% in the second half of 1997. s These rate not only dampened manufacturing but made it impossible for a moderate budget deficit in 13 billion pesos to be obtained as scheduled by Ramos. In fact by July 1998 the estimated figure for the deficit in the budget of the national government had shot up to between 50 to 70 billion pesos.

As the search for causes of the exposed Philippines situation continued, attention increasingly focused on weaknesses in the banking system. Banks had allowed people to borrowed dollars at 5% and these borrowers had tried to make more money by converting to peso, since peso accounts were paying 12%. These was, as a result, a serious shortage of dollars in the financial system. Moreover, it was revealed that the banks had not been putting aside enough to cover possible bad debts (or "non-performing loans"). The "provision" for these had dropped from 3.3% of the value of commercial loans in 1992, to only 1.5% in March 1997, despite an escalation of total lending by banks of 38% in three years - chiefly to feed the construction of luxury housing, high rise condominium booms and the Manila shopping mall craze.

The Philippines authorities were in fact, deeply embarrassed by the peso falling through the floor and the consequences of the unexpected turn in monetary event after 2 July 1997. President Ramos had carefully constructed, via his propaganda and public relations machines, the notion of "Philippine 2000," at which date his country would achieve "tiger" status. The whole thing was a fantasy based on very optimistic targets for the growth rate of GDP, on good weather for obtaining record agricultural results, on a stable currency, and on a better performance from a banking system slowly being put in touch with modern practices. All of these cornerstones of the "Philippines 2000" plan was shot to bits by the events, in the second half of 1997, with the appearance of severe exchange and monetary crises, serious drought, and failing banks (Orient Bank and Monte de Piedad bank owned by the Catholic Church). One can add to this list dwindling foreign investment as a result of uncertainties surrounding the national elections and, in particular, bad publicity about daily kidnapping of ethnic Chinese-Filipino businessmen for ransom.

All of these developments unravelled the good image of the Philippines with the IMF advisors in the know, since the Philippines had been officially under IMF tutelage for ten years and was actually awaiting permission from the Fund to exit the program, carried out most of the economic reforms required by the Fund--much to the dismay of an electorate realing from new value added taxes, soaring water and electricity bills (following both privatisation and the currency devaluation) who soon made their feelings about the effects of such "reforms" at the ballot box. Political embarrassment at the inept handling of the currency and capital flight issues continued up to the national election and naive journalists were even reduced to saying that the Philippines had been spared the worst of the woeful Asian financial processes post melt-down because the country had been receiving so little foreign investment - this situation being described as a "blessing in disguise."9

By November 1997, overseas research institutes and departments of financial lending institutions were projecting a slowdown in GDP growth of the Philippine economy. For example, Society-General Crosby Research (based in Singapore) in its publication October Economic Review downgraded tha rate of growth of GDP to 4.4% in 1997, and 3.6% fot the year after. That estimate was quite a comedown on a claimed official rate of 5.7% in 1996. The downgrading reflected a conviction that the peso would remain weak and that the very tight money approach of the Central Bank would throttle manufacturing output. In March 1998, the IMF re-adjusted figures and put the Philippine growth rate at 2.5%. The forcasting by the World Bank-IMF, the Philppine government and even both foreign and domestic business firms proves to be over-optimistic, if not engaging in wishful thinking. For 1998, the GDP growth was just 0.2%. Given a population growth of 2.5%, the 1998 GDP growth is not even enough to maintain 1997 per capita income level.

Despite these opinions and the downgrading of its GDP growth estimates, the Philippines government insisted that the "fundamentals" were sound, seizing on a reported rise in export value to 20.69 billion dollars for January-October 1997 (up from 16.8 billion the year before, but official figures also showed that the capacity to expand the volume of export had not increased. Moreover, the government was faced with revelations that unhedged foreign currency loans of Filipino borrowers were much higher than had been thought. Merrill Lynch in its house bulletin, Asian Fixed Investments for November 1997, estimated these unhedged loans at 3 billion US dollars and said that this amount was much more than was safe; it also worried that more than 12.6% of commercial lending had gone into real estate sector which had also proven to be unsafe. Here Merrill Lynch were underlining the role of bad loans in causing monetary disturbances. Once we add an extra variable - the maturity profile of overseas debt falling due - it is easy to see why the Philippines crisis was so messy and so litlle understood locally and abroad.

Some Causes of the East and Southeast Asian "Meltdown"

According to figure in the IMF publicaion World Outlook for November 1997, net private capital flows (net direct investment plus net porfolio investment plus private oversea borrowing) to Asia in recent years increased astronomically -- from US$ 3.9 billion annually for the period 1983-88 and US$ 4.2 billion dollars p.a. for 1989-95 to US$ 88.8 billion in 1995 and US$ 98.4 billion in 1996. Such absolute numbers and increase were unprecedented in the modern economic history of Asia.

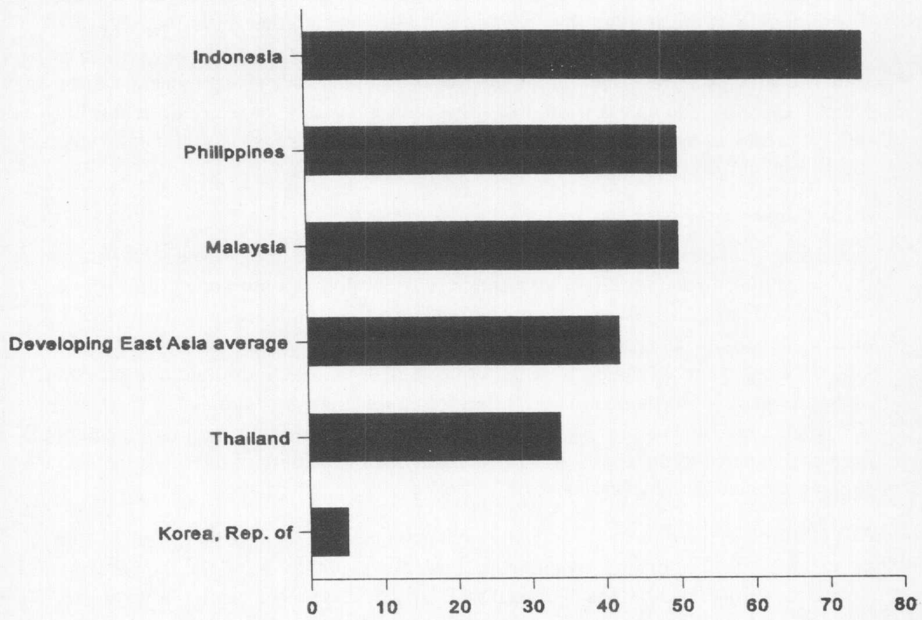
Apart from the massive increase in the amount of portfolio capital moving about Asia as compared to the 1980s, it is the volatility and instability of the flows that have become a major source of concern.

(i) Volatility: The achievment, even through good management, of the so-called "fundamentals" becomes difficult when huge flows move quickly about the region, and in and out of particular countries. This is particularly the case when capital flows are procyclical -- intensifying existing booms and slumps already under way. When the movements are unexpectedly large, as happened in 1996-98 the problem of holding up the external value of the currency and the level of share market values becomes almost unmanageable. We have already given details about the size of the currency depreciations in individual ASEAN countries; Figure 1 show the huge participation of foreign activity in the stock market whose impact on the economy can result in a combination of capital flight and falling currencies.

The final blame for the near panic withdrawals of capital -- amounting to capital flight -- must be laid at the feet of the foreign fund managers (chiefly American and Japanese). Figure 2 shows the fall of the stock market can influence the economic and financial operations in the whole chain of events. That high level of participation helps to explain the widespread desire to sell off shares which caused the decline shown in Table 1 and the continuing bearishness that followed the collapse of investment confdence. Significantly, at the November, 1997 meeting of APEC in Vancouver, there was much discussion about measures to limit the ability of fund managers

to move their clients' funds from country to country.10
(ii) Cyclical Factors: There had been in Bangkok, Jakarta, Kuala Lumpur and Manila an over-expansion of the construction boom. Real estate developers misjudge the market, leading to an over supply of dwelling units. Once the construction cycle turned down, it was revealed that banks had lent far too much to vulnerable firms. There exposures scared many foreign investors as well as speculators.
(iii) State of the News: Currency dealing and stock exchange gambling have, as John Maynard Keynes pointed out, the characteristic of a casino. This was underlined in the rapidity of downturns in currency values, share prices and bank lending during the period July-October 1997. As well, Keynes is reported to have said "tell me the state of the news and I will tell you what is happening on financial markets." With Western press commentary of Asian trends scaring foreign investors, the Asian events served as a striking vindication of Keynes' dictum.

Figure 1: Foreign Activity in Stock Market Trading (1997) Percentage of Trading Activity



Source: World Bank 1997

Enlarge this image.
(iv) Financing Corporate Expansion and Weak Bank Discipline: The method of holding retain profits in non-dollar denominations prove to be costly to those large firms use to expanding by internal self-financing rather than through bank borrowing. Most have no time to switch out fully into dollars and were forced to sustain immediate losses of up to 20%. To the extent that they had low levels of inventories or lots of "old" contracts in the pipeline they also had to absorb the higher cost of imported materials, costs of imported machinery and semi-finished goods.
One example here is Petron, the government joint venture with Saudi ArabiaAramco oil company in the Philippines. According, to reports during November 1997, in the Asia Wall Street Journal the company tried to earn more by borrowing cheap US dollar-denominated debt and holding it in high interest peso deposits (in banks etc.). Interest income grew, supplying about a quarter of pre-tax income for the company in 1996 and the strategy worked while the external value of the peso was stable, but the sharp devaluations of 1997 exposed Petron to the irksome burden of reconverting off 4.8 billion peso back to US dollar in the now more expensive debt payments for 1997 alone.
These had been, moreover, a tendency in some ASEAN countries for the banking system to alter substantially the proportion of their lending portfolio in favour of dollar loans (which were cheaper for the customer) and

against local currency loans. For example, in the Philippines, according to Central Bank figures, dollar loans amounted to US $ 12 billion in March 1997. This figure represent one-quarter of total loans and was five times the level of such dollar loans in December 1993. Another major problem was that depreciation of the local currency and dollar appreciation, loans were more expensive to service and pay back - it was more expensive to set dollars.

This softness in commercial bank lending, was a very significant item in the whole currency crisis. It weakened the major banks as profit margins narrowed; it affected the share prices of the banks; it created a temporary dollar shortage and it force the monetary authority to take action to stop banks raising interest rates and to change their asset portfolio towards what bankers call "quality assets" (performing loans).

The Central Bank of the Philippines eventually make a good intervention when it imposed a dollar flow of 30%: commercial banks had to maintain 30% of their foreign currency liabilities in the form of liquid assets such as cash placements and marketable securities.

The Main Effects of the "Melt-Down"

There is still going on a process of negative impulses working through the financial and economic systems of individual Asian states. Here we, isolate some of the impacts that happened in the short to medium term.

(1) Effects Associated With Bad Debt: Bad debt was an ASEAN-wide phenomenon. "Non-performing loans" in the form of credits from banks to investors which cannot be repaid, were largely an accompaniment of the construction boom, combined with loose financial regulations over the proportion of the banks' lending that could take this form. Realization of high levels of bad debt in the business community has, as its first effects, a dampening of confidence, of share prices and a knee-jerk reaction by banks to slash lending and raise interest rates sharply. All of this discourages local manufacturing already hit by high raw material import prices.

The whole situation of manufacturing was made worse by the fact that a lot of domestic and foreign investment in the 1990s had gone into industries where excess capacity was already evident (examples include the Indonesian and Malaysian car industry, and Filipino cement industry). At the same time loanable funds which should have been used to modernised and expand plant capacity in successful export industries (e.g. Thai textile and garments, Malaysian-based electronics, Filipino agro-industry and garments) was diverted to the speculative real estate and construction outlets.

(ii) Balance of Payments Effects: The depreciation of Asian currencies against the dollar led to automatic increases in the cost of repaying oversea debt burdens. This tends to be reinforced by rises in fuel prices for oil importing countries and raises in interest rates globally. A depreciation of 10% can lead to an increase of debt burdens of more than 2%.

The negative effects on the balanced of payments accounts in overseas trade results for the individual ASEAN countries were reinforced by the capital flight which reduced items on the payment side of the ledger in the capital account -- capital inflow normally assists the overall balance of payments result while capital flight does the opposite. However, a bad situation arises when there are further depreciations of the currency.

(iii) Implications for Labour:

a. Cost of Living: As imports became more expensive due to the falling value of the currnecy, the impulse is quickly fed into cost of living rises. This has been especially the case for countries which are oil importers, food importers, or have established their telephone and telecommunication services through loans denominated in dollars arranged with American telecommunication giants which also claim licence and royalty fees in dollars. (The Philipines experienced all these aspects. Moreover telephone companies, electric power, and water suppliers tended to add a "currency correction factor" to household bills, increasing these bills by 30% to 40%. As a result of imposts like these, the cost of living in Manila was estimated to have risen 30% for basic commoditites in 1998 compared to 1996-1997, despite official figures putting inflation at 10%. Figures quoted in Philipines Daily Inquirer, 27 July 1998.)

b. Unemployment: In the nine months following the Asia-wide meltdown, unemployment jumped by 900,000 in

Korea, by 1.2 million in Thailand, 2.6 million in Indonesia, 45,000 in the Philippines (but a million extra Filipinos in the first half of 1998). While most of these unemployment trends can be directly traced to the Asian financial crisis some of it was also due to liberalisation of trade that had been enforced by the IMF economic reform measures which were in place before July 1997. This liberalisation of trade and sharp tariff reductions had already meant that local industry could not compete with the flood of imports.

(iv) Implications for International Business:

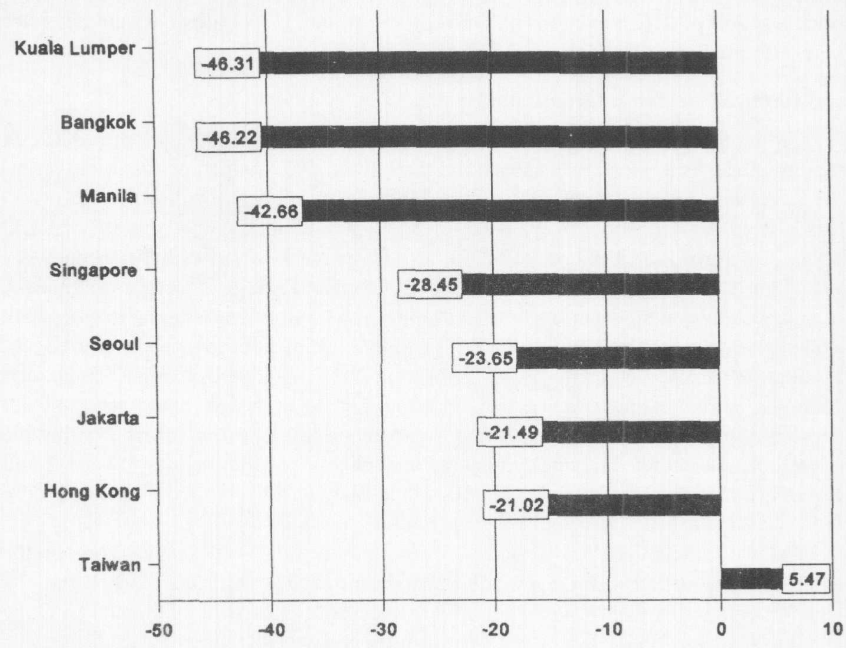
(a) Falling Stock Exchange Prices: The fall in stock exchange share prices in ASEAN (and in "East Asia") was very substantial throughout 1997 judged on historical precedents. Figure 2 below indicates the trends. Malaysia took a heavy fall, as foreign investors slowed capital inflow in the wake of scepticism about the "soundness" of fiscal policy and forced-draft industrialisation, as well as reaction to the 20% currency devaluation. The average drop was 46.3% from December 1996 to 31 October 1997. And, of course, Malaysia's experience was not unique. The comparative data for the stock exchange downturns in the other ASEAN countries were as follows: Thailand 42.6%; Philippines 42.6%; Singapore 28.5%; Indonesia 21.5%. Selling by foreign fund managers, who were reacting to the speculative attacks on ASEAN currencies, was the chief cause of the plunge. In East Asia proper, Taiwan escaped serious damage during the overall bearish trends, but stock exchange indices fell for Hong Kong (21) and South Korea (23.6). On 23rd October 1997, the Hang Seng index recorded its greatest drop for a decade. But this was only the beginning.

On 10th June, 1998 Asia's stock exchange were again thrown into chaos when the external value of the Japanese yen fell to a 7-year low. The Japanese stockmarket values fell first with the Nikkei index dropping to a low 15,331 points, followed by Hong Kong's Hang Seng index falling 4.9% below what brokers call the "psychological level" of 8,000 points. The Thai stockmarket fell next, hitting a 10-year low (with the SET index down to 292.14.) Singapore-s Straits Times index dropped by 49.4 to 1,067.18 points, Korea's composite index fell 4.3% to 323.45 point and Malaysia's index closed only one point lower. " Just after this blow to business had been delivered, something very ominous appeared on the horizon. The Japanese economy (still on its back as the result of the bursting of its "bubble" economy of 1989, and reeling from corruption scandals and a poorly-performing finance and banking sector, went into further and deeper recession -- as officially announced. As a result, an unprecedented joint action of the US and Japanese authorities to hold up the yen had to be undertaken.

These new moments in the Asian meltdown confirmed that a new stage in the regional crisis was truly at hand. The Communist Chinese holding out against devaluation remained the only strong stabiliser.

b. Reduced GDP Growth Rates of ASEAN: The article started with a critique of the super-optimistic growth projections hitherto popular in financial circles in relation to Asia. These "guestimates" were shaken by the events after 2 July 1997 and now serve as embarrassing monuments to the folly of ideas about "miracles" and the "magic of market forces." The scaling-down had started among those in the know or those of more realistic bent as early as September - October 1997. For example, in the Philippines economist de Dios12 and then other observers outside government13 had downgraded the pre-June "tiger-like" official forecast amounting to a 6.7% annual growth, down to a more sober 5% or less. Table I gives the latest "realistic" assessments by different analysts concerning rates of growth GDP for NIC's and members of ASEAN - the Table portrays a mixture of low and negative growth rates, the best expectation being + 2.5%.

Figure 2: The Fall of the Asian Stock Market (percent change, December 1996 index vs. October 31 index)



Source: Sydney Morning Herald 1997

Enlarge this image.

c. Some Responses of the ASEAN Leaders to the Unfolding Crisis: International business is keenly interested in government responses to crisis. What did they learn in the ASEAN case? In the eyes of the government leaders in ASEAN, their administrations were not to blame for the unfolding economic crisis. They had, in general, got the "fundamentals" (as understood in international business circles) right: small government budget dificits; systematic privatisation of government assets; controlled money supply; de-control of most prices. The whole currency meltdown was treated as an external shock to the system arising from unforeseeable exogenous forces outside their control -- much like the world oil price rises of the 1970s. However, by the end of October 1997, some regional politicians had begun to change their public assessments: Fidel Ramos, for example, along with Singapore Prime Minister Goh, at a World Economic Forum in Hong Kong. Some acknowledgement of weaknesses in Asian political structures were admitted to have played a role. The change probably reflected the influence of the promises that had been made to supply packages and "bailout" funds in the future as long as ASEAN countries kept their nerve and did not diverge from IMF ideology and Economic Reforms. It did not really reflect extra understanding of what had actually happened or any perspective -- useful to Labour and international business alike -- of underlying structural strain, of increasing social tension, of real prospects for resuming fast economic growth and expanded productive investment and job creation.

There was still, in late 1997, too much "whistling in the dark" within ASEAN political elites but this was dissipated by February, 1998 as the Indonesian political explosion developed, followed by the sharpening of the recession in Japan during June, 1998. However, the shock of the two stages of the unfolding crisis led, eventualy to discussion of different development strategies to get out of the situation that had arisen in one of the more dynamic regions of the global economy. Yet the debate tended to be led by academic economists like Dornbusch, or by chastened advisors to the IMF and the World Bank including Stiglitz and Jeffrey Sachs. Even in these "reassessments" and mea-culpas, what was missing was recognition of failure in the political-economic system.14

At first only a couple of Western academics (outside the Marxian stream) went into this aspect. The noted neo-classical economist, Dornbusch, told a Hong Kong World Economic Forum 15 that the Asian meltdown represented an economic policy failure, a finance and currency crisis and a political denial of reality. In other words, a system breakdown had occurred and a system change was required. The subsequent events in Indonesia strikingly confirmed this estimate.

Market Forces, Re-regulation and the Role of the State

In the 1930s, the world capitalist economy collapsed and took a long time to recover. The culprit was the operation of market forces, domestically and internationally, driven by greed.

The ramifications of how, inside America, market forces brought the economy to its knees were well described in J.K. Galbraith's book, The Great Crash, while the international damage done by incompetent market forces was detailed in Heinz Arndt's Economic Lessons of the 1930s. As a result of those experiences, markets forces were no longer trusted to deliver jobs, efficiency or optimal outcomes in the allocation of resources. Advocacy of controls over international capital movements and even taxes on them (similar to the tax proposed in 1997 by James Tobin, the Nobel Laureate in Economics) were the order of the day, with first Keynes, then Kalecki and D.H. Robertson opposing the attempts of Dexter White and other American officials to design a post-war international monetary and payments system that would make State intervention a rarity and free trade a dogma.

It cannot be denied that in the case of the current Asia crisis we have a failure of market forces as propelled through profit-hungry private sector economic agents. As Bhagwati, Sach and Stiglitz have acknowledged, there is no analogy with the Latin American banking crises or the Mexico meltdown of some years back, when there were elements of government ineptitude and overspending leading to hyperinflation. This time around it was the vortex created by the volatility of huge capital flows, the nearness of massive debt maturation, the unacceptably high proportion of bad loans in the banking system and the presence of very wealthy speculators in the currency markets that sparked what was a purely private sector affair of disastrous proportions. All the attempts since then to arrange "Economic Reforms" and to make the crisis a crisis for the working class cannot hide this basic fact.

Actually, the idea of a positive and activist role for State intervention in situations like the Asian turbulence is not new. In the period 1945-49 the American, using diplomatic pressure and the leverage provided by their powerful Import-Export Bank attempted to get a series of countries to sign a "Treaty of Friendship, Commerce and Navigation," the main aim of which was to lift controls over the movement of American capital and its earnings in and out of countries. Since those were the days of the great dollar shortage quite a few bureaucrats in Economic Ministries feared for the effects of American dividend repatriation and capital flight on their balance of payments. Hence they resisted (in the case of Australia successfully) this dilution of their sovereignty and right to State intervention.

In the late 1950s, too, Asia found itself in a spiral of inflationary pressures in the wake of the Korean war. In Australia and Thailand, in particular, the easy profits of the times soon led to a real estate boom and a bubble economy that the State finally had to end. In the case of Australia, very tight controls were introduced over household spending, but also over the commercial banks which were forced by government regulation to lodge frozen Special Accounts with the Central Bank which could be withheld and interest payments on them denied if they defied monetary policy on bank lending or investments. They were also required to maintain a legal minimum LGS or "Liquid Assets to Loans" ratio. A Report of an all-Party Committee on Constitutional Reform in 1959 recommended the introduction of capital issues and tight controls over non-banking financial lenders, part of which became law. So Australia, at least is no stranger to the idea of controlling international capital flows where they are judged to be harmful; to the national economy and no Australian government has resiled from a strong role for State intervention in these areas should they become necessary.

While there was a period of IMF hegemony when talk of State intervention against destabilising capital movements was almost taboo, it was IMF advisor, J. Stiglitz who raised the issue in 1993 when he wrote a piece called "The Role of the State in Financial Markets" in the Proceedings of the World Bank Conference of Development Economists, noting that:

In most of the Asian countries, Government has taken an active role in creating financial institutions, in regulating them, and directing credit both in ways that enhance the stability of the economy and the solving of financial problems in ways that enhance growth prospects... a simple ideological commitment to liberalisation of financial markets cannot be derived either from economic theory or from an examination of a broad base of experience.

It would appear then, that with the IMF advisors, technocrats, and neo-classical economists in disarray, with the proponents of "miracle growth" maintaining an embarrassed silence, with talk of the Tobin tax in the air, the case for State intervention is very strong and can be put plausibly. And this time around the case for mistrusting the "magic" of market forces and for designing appropriate and effective control against the anarchy of modern finance capital can get a hearing without the distraction stemming from the usual ideological howls of the Rightwing economists or the advice of uncomprehending neo-classical economists who haven't a clue about what has been happening around Asia because their analysis is static, because they inhabit a surreal world in which markets always efficiently clear because of the actions of an "infinitely small number of infinitely small economic agents," all supposedly with perfect knowledge -- a body of doctrine that cannot even analyse futures markets, let alone complex problems of capitalist economic dynamics.

Conclusions

(1) The volatility and interaction of four major viriables was the short-run cause of the Asian "meltdown" exchange rate fluctuations, equities market fluctuation, interest rate fluctuation and management of maturing foreign debt. It was difficult for any one individual ASEAN state to take action against the waves set up by these processes of dynamics interaction. 16 We believe therefore, that in the new circumstances of strong inter-linkages, it is a bit unrealistic to expect success from IMF "bail-out" of "swap" arrangements (i.e. exchanging local currency for US dollars provided by other Asian countries to dig members ASEAN out of the money crisis).

(2) Given the need for a new political economy of system change demanded by Dornbusch and others, the IMF packages (as shown in the Indonesian case) will not shake the power of entrenched elites which in the sine qua non of real improvement for the masses of Asian people. Without this shaking-out, "getting the fundamentals rights" will not mean better regulation, restored national sovereignty, high living standard and more equitable distribution of wealth and income (which are the "fundamentals" of the masses) but things like conservative monetary policy, low budget deficits, small balance of payment deficits - the fundamentals of the bankers and money market speculators.

(3) From the outset it was clear that the possibility of a total breakdown of the AsiaPacific economies was present and would break out in the case that the three "giants" of the Northeast Asian economy (China, Japan and Korea) reacted in a way that destabilised the overall Asian region. China has so far resisted the pressures to devalue its exchange rate but first Korea, and then Japan have gone into severe economic slump. A vicious cycle of transmitted recesssion is increasingly probable.

(4) The international investment community at one time believed that a dollar-based area of the capitalist-based global economy would grow strongly and also embrace Asia. While this has occurred to some extent, the recent extreme and unhealthy devaluations of so many currencies has put a question mark over the assumptions involved in keeping Asia as fundamentally a dollar region after the currency crisis ends. Should the yen recover, it is likely to play a big role, while the new "euro" currency unit could ultimately make its presence felt as well.

Footnote

Notes

Footnote

1. Reported in Business World (Manila) 27 November,1997. Further analysis throwing light on this point can be found in C. Sussangkarn, "Thailand's Debt Crisis and Economic Outlook," Melbourne Institute of Applied Economic and Social Research, May, 1998. The size of foreign debt as accentuating Thai difficullties is discussed in Bank of Thailand, The Foreign Debt, 1990-96 Bangkok, 1998. 2. Reported in Philippine Daily Inquirer, 6 December,1997.

3. A. R. Dizon "Thailand Swallows Bitter Medicine," Business World (Manila) 4 December, 1997. See also K. Pamsoonthorn, "Building A Financial Crisis," Bangkok Post, 30 June, 1997 and also the perceptive piece by U. Pathmanand, "Thailand Under the IMF," Mathichol Weekly (Bangkok), 30 September, 1997. 4. BBC News. Others to question the 1MF diagnosis on this and other points included J. Stiglitz, a leading IMF economic advisors in his piece, "How to Fix Asian Economies," New York Times, 31 October, 1997, and in Australia, Peter Brain in "Asian Economic Crisis," Institute of Economic and Industry Research, Melbourne, May, 1998.

5. Mari Pangestu, "Economic Outlook For The Indonesia Economy," Melbourne Institute of Applied Economics and Social Research, May, 1998.

Footnote

6. Reported in Philippine Daily Inquirer, 20 November, [997. 7. Reported in Philippine Daily Inquirer, 28 July, [997.

8. Mariane Go, "Cabinet Body Sees Five Percent Growth Rate," Philippines Star, 4 December, 1997. 9. Editorial, Philippine Daily Inquirer, 6 December, 1997.

10. Reported in Philippine Daily Inquirer, 24 November, 1997. Behind the concern lay the size of the annual capital flow into Asia shown in the statistical tables of World Outlook, November, 1997 published by the IMF, and the volatility shown by the statistics in the same organisation's Global Economic Prospects and Policies, 1997.

1. Reported in the newspapers Sydney Morning Herald, and The Australian, II June, 1998. 12. These revised estimates of the officially circulated figures were reported in the Philippines Daily Inquirer, 18 September, 1997 (for new calculations by de Dios). 13. Reported in the Philippine Daily Inquirer 25 October, 1997.

Footnote

14. The idea that the IMF was giving the "wrong medicine" because it had missed this point was raised by Sachs in his article, "The Wrong Medicine for Asia," New York Times, 3 November, 1997. The slow reawakening of reality about ASEAN developments which emergd among ASEAN economic official was discussed in M. Duplito, "Asia Ponders Next Move," Business World (Manila), 10 December, 1997. Subsequently, Jagdish Bhagwati described the system failure in very critical terms in his article, "The Capital Myth," Foreign Affairs, May-June, 1998.

15. A long summary of Dornbusch's speech appeared in P. Kelly, "Some Asian Tigers Have a Low Pain Threshold," The Australian, 15 October, 1997. An earlier questioning of the ASEAN system may be found in B. McFarlane, "The Acceleration of ASEAN Growth and Its Limitations," in Kyoko Sheridan, (ed.) Emerging Systems in Asia (Sydney: Allen and Unwin, 1997). 16. See M. Cassard and D. Folkers-Landsau, "Sovereign Debt: Managing the Risks," Finance and Develop
ment, December, 1997.

17.Advocacy of a yen zone for East Asia is found in C.H. Kwan, Economic Interdependence in the AsiaPacific, (London: Routledge, 1994).

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